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May Lawyers Collect Whistleblower Bounties Under Dodd-Frank Act?

By **Barry Temkin**

May lawyers ethically collect whistleblower bounties from the government in exchange for revealing confidential client information to the Securities and Exchange Commission? Regulations promulgated by the SEC under the authority of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 permit the payment of bounties to whistleblowers who report corporate wrongdoing to the government. These bounties can be quite substantial, and can range from 10 percent to 30 percent of the amount of the fine ultimately levied by the SEC, the U.S. Department of Justice, or the Commodity Futures Trading Commission. Given recent fines extracted by the government, the potential bounties can be eye-popping indeed. On Oct. 1, 2013, the SEC announced the payment of a $14 million bounty to an anonymous tipster under the Dodd-Frank whistleblower program.[1]

What does whistleblowing have to do with lawyers? The SEC's public pronouncements on the topic reassure the practicing bar that lawyers are not required or expected to cash in on client confidential or privileged material. SEC Rule 21F-4(b) presumptively excludes the use of privileged or confidential information from its definition of eligible original information under the Dodd-Frank whistleblower rule.[2] But there are exceptions to the SEC's proscription on lawyers as whistleblowers for money. Where permitted by state ethics rules, and in the event of client perjury, SEC regulations permit a lawyer to collect a whistleblower bounty.

Another SEC exception in the whistleblower rules incorporates 17 CFR Section 205, the attorney ethics regulation promulgated under the Sarbanes-Oxley Act, which permits (but does not require) lawyers to reveal client confidences to prevent an issuer from committing a material violation of the securities laws, or to rectify the consequences of a material securities law violation in furtherance of which the attorney's services were used.[3] By incorporating the language of Rule 205, the SEC whistleblower rules would permit lawyers to reveal confidential client information in circumstances far broader than those of most jurisdictions, including New York and California. Moreover, the SEC has taken the position, in its Rule 205.1, that its regulation of attorney conduct preempts conflicting state regulations, including ethics rules.[4]

Recent developments suggest that lawyers presumptively may not reveal client confidences in exchange for whistleblower bounties.

Let's assume that a hypothetical New York lawyer learns, in the course of her representation of a client, of confidential information about a client's material violation of federal securities laws. The violation does not amount to a crime, and the lawyer's services were not implicated in the underlying violation. May that lawyer ethically report the corporate wrongdoing to the SEC and collect a multi-million dollar whistleblower award? Recent developments suggest that lawyers presumptively may not reveal client confidences in exchange for whistleblower bounties.

NYCLA Ethics Opinion 746

On Oct. 7, 2013, the Professional Ethics Committee of the New York County Lawyers' Association (NYCLA) issued Ethics Opinion 746, "Ethical Conflicts Caused by Lawyers as Whistleblowers under the Dodd-Frank Wall Street Reform Act of 2010."[5] (The author is co-chair of the committee.) The NYCLA ethics committee posed the question, "May a New York lawyer ethically participate in the whistleblower bounty program under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 by revealing confidential information about the lawyer's client and then seek a bounty?"[6]

The committee's conclusion is that the New York Rules of Professional Conduct (RPC) would presumptively prevent a New York lawyer, acting as a lawyer for a client, from seeking whistleblower bounties in situations in which the lawyer reveals client confidences. There are two significant ethical issues raised by the prospect of a government payment to a lawyer in exchange for revealing confidential client information. First, the Dodd-Frank whistleblower regulations might permit disclosure of client information to the government in situations in which such disclosures would not be permitted by the New York Rules of Professional Conduct. Second, the prospect of receiving a substantial monetary bounty from the government might give rise to a significant risk of a conflict between the lawyer's interests and those of the client, in violation of Rule 1.7 of the RPC.

While New York's RPC have six exceptions to the general duty to maintain client confidences, none of these exceptions is as broad as SEC Rule 205, which permits a lawyer practicing before the commission to reveal client confidential information in order to prevent or rectify, in certain circumstances, a material violation of the securities laws. There is, to be sure, some overlap between SEC regulations and state ethics rules. For example, New York's RPC 1.6(b) permits a lawyer to reveal client confidences "to prevent the client from committing a crime," which obviously would include some, but not all, forms of securities fraud. And a lawyer may be required to reveal confidential client information "if necessary" to prevent or rectify known perjury or fraud on a

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tribunal.[7] However, even when falling within the six enumerated exceptions in RPC 1.6(b), the New York ethics rules only permit disclosure of client confidences "to the extent the lawyer reasonably believes necessary…."[8]

According to the NYCLA ethics committee, collecting a monetary bounty from the government is rarely necessary: "Even when disclosure is permitted under the New York Rules, for example, when clear corporate wrongdoing rising to the level of crime or fraud has been perpetrated through the use of the lawyer's services, preventing wrongdoing is not the same as collecting a bounty. Even in cases of clear criminal conduct or fraud, the lawyer's disclosure must be limited to reasonably necessary information."[9]

An additional ethical problem is presented by the prospect of a lawyer's seeking to collect a whistleblower bounty. A lawyer seeking to benefit personally from the disclosure of confidential information could run afoul of RPC 1.7, which precludes representation of a client, absent waiver, where a reasonable lawyer would conclude that "there is a significant risk that the lawyer's professional judgment on behalf of a client will be adversely affected by the lawyer's own financial, business, property or other personal interests."

According to the NYCLA ethics committee, "the potential payment of an anticipated whistleblower bounty in excess of $100,000 presumptively gives rise to a conflict of interest between the lawyer's personal interest and that of the client."[10] The committee reasoned that the prospect of a financial bounty might adversely affect the lawyer's professional judgment on behalf of the client. Moreover, the ethics opinion stated that many of the same ethical considerations would apply for in-house and outside counsel, and with respect to former and well as current clients.

While the NYCLA ethics committee did not directly address the federal preemption issue, it did observe that the SEC regulations themselves explicitly acknowledged the side-by-side existence of state ethics regulations and attorney-client privilege. Moreover, in a recent reported decision, the SEC applied the New York Rules of Professional Conduct to prosecute and discipline an attorney who attempted to obstruct an SEC investigation, thereby acknowledging the role of state ethics rules for attorneys appearing before the commission.[11]

'Fair Laboratory'

On Oct. 25, 2013, the U.S. Court of Appeals for the Second Circuit decided *Fair Laboratory Practices Associates v. Quest Diagnostics*, which considered the interplay between state ethics rules and the False Claims Act, in a qui tam case brought by a lawyer-whistleblower who alleged that his former employer had violated the federal anti-kickback statute.[12] In that case the defendant's former general counsel had learned of kickbacks and other corporate wrongdoing several years before he brought the qui tam proceeding. Armed with an expert affidavit from legal ethics guru Steven Gillers, the defendant claimed that the lawyer, Mark Bibi, had breached state ethics rules by using confidential information to bring the qui tam claim. The former general counsel demurred, arguing that state ethics rules were preempted by the False Claims Act. Alternatively, Bibi argued that his disclosure was permissible under the predecessor to New York RPC 1.6(b) in order to prevent the client from committing a crime.

Given the permissive nature of the whistleblower bounty program, it is unlikely that a court would conclude that accepting a monetary benefit from the government is reasonably necessary.

The Second Circuit held that the relator's qui tam case had been properly dismissed for the lawyer's unnecessary and improper revelation of confidential client information. The court determined that RPC 1.6 and 1.9 were not preempted by the False Claims Act, because these rules would permit the disclosure of confidences to the extent "reasonably necessary" to prevent a crime—including a federal crime. According to the court: "Nothing in the False Claims Act evinces a clear legislative intent to preempt state statutes and rules that regulate an attorney's disclosure of client confidences."[13] The court reasoned that, "Because Rule 1.6 itself balances the interests at stake, it need not give way to [the False Claims Act's] requirement of full disclosure of material evidence."[14] There was no conflict between state and federal interests, because it was not necessary for the general counsel to reveal stale confidential information from years earlier in order to prevent fraud that was apparently no longer ongoing.

According to the Second Circuit, "We agree with the District Court that the confidential information Bibi revealed was greater than reasonably necessary to prevent any alleged ongoing fraudulent scheme in 2005."15 Having found that the revelation of client confidences was not reasonably necessary, the Second Circuit concluded that the entire case was infected by the attorney's unethical disclosures, and was not improperly dismissed by the district court.

Conclusion and Analysis

Both NYCLA Ethics Opinion 746 and the Second Circuit's decision in *Fair Laboratory* warn that the disclosure of client confidential information in exchange for a government bounty raises significant ethical issues for lawyers. While the *Fair Laboratory* case, as mentioned, involved the False Claims Act and not Dodd-Frank, the Second Circuit approvingly cited NYCLA Ethics Opinion 746 in a footnote. Moreover, the Second Circuit was not receptive to the plaintiff's blanket preemption argument, and followed other circuits in balancing federal interests against state confidentiality rules.

Given the permissive nature of the whistleblower bounty program, it is unlikely that a court would conclude that accepting a monetary benefit from the government is reasonably necessary. While it is hard to predict the future, it is unlikely, following *Fair Laboratory*, that a federal court would find a direct conflict between state ethics rules and the SEC's Dodd-Frank whistleblower program. Among other factors, the whistleblower rules are permissive; the SEC elected to use a carrot rather than a stick. There is no federal regulation requiring a lawyer to accept a cash bounty in exchange for blowing the whistle on a client. Even when it is permissible or even necessary for a lawyer to reveal client confidences, it is not necessary to collect a bounty in exchange for doing so. Moreover, the prospect of receiving a whistleblower bounty raises a significant risk of a conflict between the client's interests and those of the lawyer.

1. http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539854258.
2. See Implementation of the Whistleblower Provisions of Section 21F, Exchange Act Release No. 34-64545, at 50-52, 60-66, 249-50 (Aug. 12, 2011), available at http://www.sec.gov/rules/final/2011/34-64545.pdf.
3. 17 CFR §205.3(d)(2).
4. 17 CFR Section 205.1, http://www.sec.gov/rules/final/33-8185.htm.
5. NYCLA Ethics Opinion 746, https://www.nycla.org/siteFiles/Publications/Publications1647_0.pdf.
6. NYCLA Eth. Op. 746 at 1.
7. See RPC 3.3 (b).
8. NY RPC 1.6 (b); See, NYSBA Comm. on Prof'l Ethics, Op. 837 (lawyer must take reasonable remedial measures under RPC 3.3 to correct client perjury, but may only reveal client confidences to the extent reasonably necessary).
9. NYCLA Eth. Op. 746 at 9.
10. NYCLA Eth. Op. 746, www.NYCLA.org, at 11.
11. See, e.g., *SEC v. Steven Altman*, Securities Act Release No. 34-63306 (Nov. 10, 2010); *Steven Altman v. SEC*, 666 F.3d 1322 (D.C. Cir. 2011) (disciplining lawyer for violations of NY RPC based on extortionate conduct which impeded SEC investigation).
12. No. 11-1565-cv, http://www.ca2.uscourts.gov/decisions/isysquery/df24018a-2ce7-4817-8df5-289221993739/1/doc/11-1565_opn.pdf.
13. *Fair Laboratory*, at 15.
14. *Fair Laboratory*, at 18.
15. *Fair Laboratory*, at 19.